



H.B. 696 Would Modernize North Carolina Nonprofit Laws

The North Carolina Center for Nonprofits, which works with nonprofits serving all 100 counties of North Carolina, strongly supports H.B. 695 (Various Changes to Nonprofit Corporation Act). **H.B. 696 would allow nonprofits to operate more efficiently and to use more of their time and money for their mission-related programs, services, and activities.**

Specifically, H.B. 696 makes five important changes to the NC Nonprofit Corporation Act:

Mergers and dissolutions of nonprofits. During the COVID-19 pandemic, a growing number of nonprofits are having difficulty maintaining the financial resources necessary to sustain their operations. As a result, there has been an increase in mergers between nonprofits and in dissolutions of nonprofits. In many situations, the merger or dissolution of a nonprofit is the most efficient way to ensure that another organization can use the nonprofit's remaining charitable assets for the best possible purposes to support communities. The current nonprofit corporation law has two limitations that can create unnecessary barriers to effective mergers and dissolutions:

1. The statute does not expressly permit mergers between unincorporated nonprofit associations (which are governed by Chapter 59B of the General Statutes) and nonprofit corporations or between nonprofits and limited liability companies (LLCs) that are treated as 501(c)(3) charitable organizations for federal tax purposes.
 2. The statute generally requires nonprofits to seek review by the Attorney General of any significant transfers of assets. When a 501(c)(3) nonprofit dissolves, its board of directors has a duty to develop a plan of dissolution to protect its charitable assets by transferring them to another nonprofit. The additional review by the Attorney General often requires a dissolving nonprofit to use a significant portion of its remaining assets for legal fees rather than for charitable purposes.
- **H.B. 696 would address these issues by: (a) expressly allowing for mergers of nonprofit corporations with unincorporated nonprofit associations and with LLCs that are treated as 501(c)(3) tax-exempt entities for federal tax purposes; and (b) exempting transfers of assets of a dissolving nonprofit – if the dissolution is properly approved by the nonprofit's governing board – from review by the Attorney General. These changes were included in H.B. 732 in the 2019 session, which the House unanimously approved.**

Nonprofit annual reports. Unlike most states, nonprofits incorporated in North Carolina do not file basic annual reports with the state. This means that many defunct nonprofits continue to exist as legal entities in North Carolina. Currently, more than 120,000 nonprofits are incorporated in North Carolina, but only about 36,000 tax-exempt organizations file some variation of the Form 990 with the IRS. This large and growing number of defunct (but still existing) nonprofits makes oversight of the state's nonprofits more challenging and creates an opportunity for potential fraud and abuse.

- **H.B. 696 would address this issue by creating a simple, online, no-fee annual reporting requirement for North Carolina nonprofit corporations. This proposal was included as Part III of S.362 in the 2019 session, which the Senate unanimously approved.**

Domestication of nonprofits. In 2014, the Internal Revenue Service issued guidance explaining that tax-exempt nonprofits can change their state of incorporation without having to re-apply for tax-exempt status by following state laws for domestication of foreign nonprofits. Currently, the NC Nonprofit Corporation Act does not allow for domestication of foreign nonprofits, so nonprofits that are changing to their state of incorporation to or from another state must create a new legal entity and then merge or transfer assets from the previous entity to the new entity, and then re-apply for tax-exempt status. This process creates unnecessary costs and administrative burdens for these nonprofits.

- **H.B. 696 would address this issue by adopting a form of the domestication provision in the Model Nonprofit Corporation Act.**

Number of nonprofit directors. Currently, North Carolina law allows nonprofit corporations to operate with only one board member. A single-member board can make it impossible for a nonprofit to take action on matters if the board member has a conflict of interest. It is also inconsistent with nonprofit best practices guidelines (e.g. the Center's *Principles & Practices: Best Practices for North Carolina Nonprofits* recommends that nonprofits have at least five board members) and with the Model Nonprofit Corporation Act (adopted by many other states), which requires nonprofit corporations to have at least three board members.

There are two situations where it may be reasonable for nonprofits to have a single board member:

1. A foundation that was established by a single individual or family may be able to operate effectively with only one board member; and
 2. In some circumstances when nonprofits are going out of business, board members resign while the nonprofit is winding up business and it is difficult to recruit new board members for the dissolving nonprofit.
- **H.B. 696 would address this issue by requiring North Carolina nonprofits to have at least three board members with limited exceptions for private foundations and for nonprofits with vacancies in board positions.**

Electronic voting. The NC Nonprofit Corporation Act allows nonprofits' boards of directors and members to take actions outside of meetings by unanimous written consent. Under the current statute, nonprofits must include language in their articles of incorporation or bylaws opting in to electronic voting if they want to allow directors or members to use email or other means of electronic transmission for these types of votes. During the COVID-19 pandemic, some nonprofits discovered that their governing documents did not include this "opt-in" language and have had difficulty taking action when members or boards have been unable to meet in person.

- **H.B. 696 would replace the current "opt in" provisions for use of email for actions by unanimous written consent with "opt out" language. The House unanimously passed a similar change earlier this year in H.B. 320, and the Senate unanimously passed a similar change in S.410.**